

# **The Industry Must Surmount The Universal Mold Exclusion**

Without specially adapted real estate environmental liability insurance covering mold-related damages, the risk of default on any commercial property is high.

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The success of the insurance industry in managing its mold related loss exposure has made it more difficult for borrowers and mortgage lenders to manage theirs. Fresh from its experience with asbestos and superfund claims, the insurance industry moved at record speed to exclude mold losses in all forms of prospective insurance coverage.

Instead of charging higher premiums for the new source of runaway claims, insurance companies chose to avoid future exposure and losses by simply excluding coverage. As a result, borrowers, mortgage lenders, servicers and securitized lenders/investors are now left uninsured and unsecured for a peril that has proven to make buildings valueless and create toxic tort liability claims measured in the tens of millions of dollars on individual properties on a frequent basis.

As of today, few borrowers and lenders have taken advantage of the full array of risk management options available to them. However, during this same time frame, thousands of plaintiffs' lawyers, attended hundreds of "mold is gold" seminars, and by 2002 insurance companies were desperately looking for a way out of the toxic-mold morass.

Insurance companies issued tens of millions of mold-related claims exclusions and limitations. In so doing, they successfully pushed mold losses back into the economy as uninsured losses. And they did it without reducing their rates.

By 2005, the insurance companies had stopped covering mold-related losses in virtually every form of commercial insurance including property, builders risk, general liability and professional liability policies. Real estate owners and, therefore, their lenders were left uninsured.

The final resting place for uninsured mold-related damages in the economy has yet to be determined. But one thing is certain: These tens of millions of mold-

related claims exclusions in property and liability insurance policies will have a material financial impact on somebody.

So far, many mortgage lenders, banking regulators and rating agencies have seemed oblivious to the issue of being unsecured for a peril with such a substantial loss content.

These same borrowers and lenders have alternatives available to them today to manage mold-loss exposures. Most have failed, however, to effectively use them. Many others are not even aware that solutions exist.

### ***Huge Losses***

The Insurance Information Institute estimates that mold-damage claims cost the insurance industry \$3 billion in 2002 (the year before they started issuing exclusions). That figure went as high as \$12 billion when including toxic tort personal injury claims. To put mold-related losses into perspective, the total insured loss from fires in 2002 was \$12.6 billion dollars, according to the institute.

Mold-related damages to property did not disappear with the insurance coverage. new mold-related damages occur every day, and the number of specialized mold-remediation contractors has remained stable. That means there is a significant number of mold related losses that are no longer insured but still being incurred. Some of these properties ultimately will end up on the books of the mortgage bankers in the form of nonperforming loans.

There have been widespread adverse effects of universal mold-related claims exclusions in wind-and flood- damaged areas. It is common knowledge that mold can make a building valueless. Borrowers, lenders, banking regulators and rating agencies that are slow to acknowledge the effects of insurance exclusions for mold are likely to regret it. At a time when the mortgage lending and insurance industries are spending so much time wrestling with the issue of terrorism exposures and potential losses, mold strikes an average of 10 to 1,000 homes and buildings every day. Considering the insurance industry's view of loss exposure, a high frequency loss scenario is much worse than a high-severity scenario.

For decades, secured lenders have required borrowers to obtain property and liability insurance. Lenders have consistently outlined exactly how this insurance should be provided in the loan covenants.

Risk avoidance is not a risk management alternative for mortgage lenders or securitized lenders/investors because to avoid mold risks they would need to stop the deal flow and stop lending money. Obviously, this is not an option with existing loans, either. Therefore, lenders will need to rely on risk identification, loss prevention and innovative environmental insurance products to manage their

mold-related loss exposures or wait for the insurance industry to back into the marketplace with newly structured mold coverages.

Lenders also need to specifically address mold exposures in their insurance requirements to close these coverage gaps between the insurance policies they asked for in the loan covenants and the coverage actually being provided by the borrowers.

To protect their security interests in property, virtually all secured lenders require all-risk property insurance. Banking regulators and rating agencies depend on insurance to be in place when evaluating the quality risk in a lender's portfolio. These property insurance policies pay for the replacement of insured buildings and contents which may be damaged by a wide range of insured perils, including fire, windstorm, civil commotion, aircraft, smoke, hail, rain, riot, malicious mischief and explosion. The all-risk property insurance policy is designed to cover all risk of loss except for those specifically excluded.

Regulators and rating agencies rely on the underlying insurance on securitized loans to evaluate the risk quotient of the lending institution or a portfolio of loans for the secondary market. However, none of the rating agencies or regulators has captured the ramifications of universal mold exclusions.

### ***Universal Exclusion***

The coverage impact of mold exclusions is not well-understood by insurance practitioners or lenders because they have their roots in pollution exclusions. And pollution exclusions are highly litigated.

The universal exclusion of mold related claims in all commercial insurance policies, including the builders risk policies (purchased to cover property damage occurring during construction) and other property insurance policies, has created a material gap between the specified insurance required for commercial loans and the insurance actually provided by the borrower.

Without specially adapted real estate environmental liability insurance covering mold-related damages (including the cleanup of mold and related business-interruption expenses), lenders face a greater risk of default on any property that develops water-intrusion problems leading to mold.

**Q.** I had water damage at the beginning of April from a sump pump back up. It took 4 days to get someone out to start the cleanup because everyone had a back log of jobs. The ABC Company came out and found that my wet bar was built on top of the carpet but they said they could not remove the carpet without tearing up the wet bar, thereby increasing the damages. They CLAIM that it miraculously escaped the water damage. They did pick up the hearth for the woodstove and tore the other carpet out. When the insurance agent was here I had shown him the wall board that was wet about 2 inches up.

I had noticed it because it looked like the paper covering was wall paper that had buckled. ABC decided that they could dry those walls out. 3 days after they were here, the prong detector was still showing dampness but when they returned they said that they were not getting dampness readings any longer. They and the agent say that the wallboard does not need to be replaced. At least one contractor has told me that the standard practice is to remove and replace the bottom 2 feet of wallboard, re-tape the wall, and then repaint the walls after adding a dry anti mold agent into the paint. When they submitted their estimate the insurance agent refused to authorize the work. I want to be sure that I do not have any residual mold issues because of this incident. I have mold and mildew remediation coverage AND sump and sewer back up coverage. What is the standard of practice in this kind of case? It seems to me that once that wall was wet, it will not be the same even IF they did get it dry. What should my next steps be? I have called contractors for estimates and the agent sent me his estimate and checks to get started BUT I do not want to cover up something and let it breed. Any suggestions or referrals would be most appreciated. [May 12, 2005]

**A.** Because the walls the carpeting were wet more than 24 hours, it is likely that mold growth will have begun in both items. The carpeting/padding needs to be removed and discarded, even if that means difficulties in moving the wet bar above the carpeting. The recommendation made to you to cut out at least 2 feet of drywall from the floor upward is very wise, but it is only one of 25 steps for safe and effective [mold remediation](#). The recommendation to use a mildicide containing paint is an inadequate mold remediation step. Protect your family health and home investment by your doing or paying for entire home mold inspection and testing, utilizing either do it yourself mold test kits from a large hardware or home improvement store or a [Certified Mold Inspector](#). You need to know whether airborne mold spores from the basement mold have traveled in air currents to mold cross contaminate your entire house and its heating/cooling system. To help you collect on your mold insurance coverage [very rare to have that coverage in these days of mold exclusions in most insurance policies], you would be wise to hire the services of an independent insurance adjuster who works solely on your behalf against the insurance company on a commission basis.

**Q.** I am considering the purchase of condominium on the top floor of a building. In contract negotiations, the owner submitted a mold disclosure sheet stating the possibility of mold and that a mold test had never been done. The owner lived with a leaky, concrete-slab ceiling for 12 years before the roof was replaced and the leakage stopped. We are going to schedule a mold inspection, but I would like to know some options beforehand. I have several questions: 1. Can mold be completely remediated from concrete, wooden window frames, and the space between the exterior bricks and drywall? 2. If so, what is the procedure? 3. How long would it take for complete remediation? Days, weeks, months? 4. I have heard that once a dwelling has been tested positive for mold, a permanent record is kept which will affect any future sale of the unit. True or false? 4. I have heard horror stories about buildings (all of the condos in the building) permanently losing all of their property value because mold can never be totally remediated in the affected apartment. Once one unit tests positive, the value of all units are affected whether they have had mold or not. True or false? 5. I have heard that insurance companies will not insure apartments that have been tested positive for mold in the past. Will they insure the property after remediation? 6. Would YOU purchase a unit that has tested positive for mold in the past, but had been remediated? [May 2, 2005]

**A.** Even if the mold problem is totally uncovered and fixed, you are likely to have to reveal

the mold history of the condominium and the building to any prospective buyers and tenants in the future, making the condominium difficult to re-sell or to rent. If there has been an insurance claim or water or mold damage filed within the past 5 years for the condominium or the condo building, it is likely that the condominium and the building are both black-listed by inclusion in the infamous C.L.U.E. database that insurance companies operate to share information with one another about such past building claims for purposes of denying future insurance, canceling existing coverage, or placing high premiums for coverage. Insist that the seller provide you with a CURRENT C.L.U.E. report [which only a property owner, not a prospective buyer, can order]. Information is kept in the C.L.U.E. database for 5 years. Assuming that the roof concrete slab water issues are permanently fixed [hire a physical engineer to check out the roof for water tightness and waterproofing and the quality of the roof replacement and water intrusion repairs previously made], you would need to remove and discard all of the drywall, wood, and other cellulose-based building materials from the condominium, and complete the 25 steps recommended for safe and effective [mold remediation](#). Such total removal and discarding of building materials, fungicidal treatments, and the rebuilding of the condominium could be done in a few months time by a motivated, professional mold remediation company, at huge expense to you, of course. It is possible for mold remediation to cost more than the value of a home. I personally would not buy a home or building with a mold history unless the building had been completely inspected and tested by a [Certified Mold Inspector](#) so that I would know the true mold status of the home or building prior to closing the purchase. Of course, I would expect that the value of the home or building would be sharply reduced by the seller because of the high mold remediation expenses and the difficulty of re-selling or renting a home or building with a mold history.